THE 1991 AGM AND SIXTH ANNUAL CONFERENCE

The 1991 Updates

1. MARINE INSURANCE
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I have been asked to give a summary of recent developments in marine insurance and, although there have not been many cases on the subject, I am proposing to discuss four cases which are of particular interest.

Perhaps the most significant development in marine insurance in recent months came in May 1991 with the House of Lords decision in *Bank of Nova Scotia v Hellenic Mutual War Risks Association: The "Good Luck"* (1991) 2 WLR 1279 and I intend to discuss this in some detail. This concerns the effect of a breach of warranty on a contract of marine insurance and the interpretation of s.33 of the Marine Insurance Act 1906.

The Sale of Goods Act 1979 defines a warranty as a term "breach of which may give rise to a claim for damages but not to a right to reject the goods, and to treat the contract as repudiated". This definition is applied generally in the law of contract today, with the result that breach of a warranty will give rise to a claim for damages but will never entitle the other party to terminate the contract.

This should be contrasted with the definition of a warranty contained in s.33 of the Marine Insurance Act which provides that:

(i) A warranty ... means a promissory warranty, that is to say, a warranty by which the assured undertakes some particular thing shall or shall not be done, or that some condition shall be fulfilled, or whereby he affirms or negatives the existence of a particular state of facts.

(ii) A warranty is ... a condition which must be exactly complied with, whether it be material to the risk or not. If it be not so complied with, then subject to any express provision in the policy, the insurer is discharged from liability as from the date of the breach of warranty, but without prejudice to any liability incurred by him before that date.

In the *"Good Luck"*, the Court of Appeal was of the opinion that this definition,

coupled with the insurer's right to waive the breach under s.34 of the Act, had the effect that a breach of warranty did not automatically bring the contract to an end. It was a matter of choice for the insurer: he could treat the contract as being at an end if he so chose. The interpretation of s.33 was crucial to the bank's claim against the defendant P&I Club. The vessel "Good Luck" was entered in the P&I Club, whose rules provided that every insurance given by the Club "shall contain a warranty by the owner" that all prohibitions referred to in the rules shall be acted upon and complied with by the insured ship. This took place during the Iran-Iraq war and one of the prohibitions was against vessels entering the areas of the Shatt Al Arab and Khor Musa and approaches.

The "Good Luck" was one of a number of vessels owned by the Good Faith Group which were mortgaged to the plaintiff bank. As part of the financing arrangement, the Club had undertaken to the bank that it would advise the bank promptly should the Club cease to insure the vessels. In November 1981 the Club discovered that vessels belonging to the Group, including the "Good Luck", were entering the prohibited area without payment of the required additional premium. Although the Club's agent concluded that Good Faith was aware that its vessels were uninsured whilst in the area and fully intended to continue the practice, the Club did nothing to halt the practice or to require the Group to pay the additional premium, nor did it take steps to inform the bank of the situation.

In June 1982, while Good Faith was in the process of renegotiating its loans with the bank, the "Good Luck" was hit by an Iraqi missile in the Khor Musa Channel and was so badly damaged that she became a constructive total loss. Although the bank was advised of the loss, it was not told that the vessel had been in a prohibited area at the time of the loss. On the basis that the vessel was worth the sum for which it was insured, the bank completed the refinancing agreements and permitted the Good Faith Group to draw down an additional US$2.5m. The Club later rejected the Group's claim in respect of the loss of the "Good Luck" because of the breach of warranty. The bank contended that the insurance had ceased as soon as the vessel had entered the prohibited area and claimed damages from the Club for breach of their undertaking.

On appeal, the House of Lords agreed with the bank. The Court of Appeal's interpretation of s.33 was held to be incorrect. Section 33 operates to discharge the insurer from liability *automatically* as from the date of the breach of warranty. Discharge is not dependent upon any decision by the insurer to treat the contract of insurance as at an end. Lord Goff felt that s.33 reflected normal practice in marine insurance of using the term "warranty" to signify a condition precedent: compliance with the warranty is a condition precedent to the attaching of the risk. He went on to

explain that breach of warranty does not have the effect of avoiding the contract *ab initio* nor of bringing the contract to an end, as there may be obligations of the assured which survive the discharge of the insurer from liability, for example, a continuing liability to pay a premium. The effect of the breach of warranty is to discharge the insurer from liability as from the date of the breach, unless the insurer waives the breach. As far as the "Good Luck" was concerned, the Club had ceased to be under any liability to pay as soon as the ship had entered prohibited waters and the warranty was broken. The insurance had ceased but the Club had not informed the bank. The Club was therefore in breach of contract and was liable to pay damages in respect of the US$2.5m draw down plus accrued interest.

Although s.33 provides that breach of warranty may be waived by the insurer, it should be noted that waiver is not effective unless the insurers are in possession of all the material facts. If conduct is being relied on to constitute waiver, such conduct must evince an intention to waive the breach.

Marine policies contain warranties of various types, both express and implied, and it is important to note the effect of a breach of such a warranty. The breach does not merely suspend the insurer's liability while the breach lasts and no action is required on the part of the insurers to terminate their liability. The insurers can waive the breach but unless they do so at once they cease to be liable. Unless it is really intended to have these consequences, the parties to a marine policy should avoid using the word "warranty". Insurers and Clubs who enter into undertakings with banks should also be warned that failure to comply with the undertaking could prove very expensive.

The next case, *Bain Clarkson Limited v Owner of "Sea Friends"*, (1991) 2 Ll.Rep. 322 concerns the rather unhappy state of affairs in relation to professional fees, insurance premiums and similar expenses incurred in respect of a ship. Bain Clarkson, the brokers, had incurred liability for premiums to Lloyds underwriters in respect of hull insurance for the "Sea Friends". They issued a writ against her owners for $15,000 in respect of unpaid premiums and applied to the Admiralty Court to arrest the ship for non-payment of the premiums. They relied on s.20(2)(p) of the Supreme Court Act 1981 which permits arrest of a ship for a claim by an "agent in respect of any disbursements made on account of a ship".

The Admiralty Judge had refused to permit the arrest of the vessel and the Court of Appeal upheld his decision. Firstly, it was stretching the language of s.20(2)(p) to include an insurance broker within the term "agent". Secondly, although an insurance premium may be a disbursement in respect of a ship, it is not a disbursement "made on account" of a ship. It is not concerned with the operational aspects of a ship's life,

but is made to protect the financial interests of the owners. Fuel oil is an example of a disbursement which would be within the sub-section, being an item needed to keep the ship going. Insurance was not needed to keep the ship going and she could sail uninsured (although, of course, this is unlikely). Section 20 is founded on the International Convention Relating to the Arrest of Seagoing Ships 1952 and that Convention did not include insurance premiums among the maritime claims justifying arrest as a matter of policy.

It should be noted that this decision is inconsistent with the decision of the High Court of Hong Kong in the *"Atlantic Trader"* (LMLN 295 23rd February 1991) which was expressly disapproved of by the Court of Appeal: The absence of a right to arrest for insurance brokers, lawyers and others who supply services to shipowners rather than to the ship has long been a criticism of the Arrest Convention which is now under consideration for a major review.

In *Firma C-Trade S.A. v Newcastle Protection and Indemnity Association: The "Fanti" and "The Padre Island"* (1991) 2 AC 1 the question for the House of Lords was whether a third party (the cargo owner) could rely on the Third Parties (Rights Against Insurers) Act 1930 to enforce an indemnity given to a member by a P&I Club. Section 1 of the Act provides that:

> "(1) Where under any contract of insurance a person is insured against liabilities to third parties which he may incur, then ... in the case of the insured being a company, in the event of a winding-up order being made, ... if, either before or after that event, any such liability as aforesaid is incurred by the insured, his rights against the insurer under the contract in respect of the liability shall ... be transferred to and vested in the third party to whom the liability was so incurred ...
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> (4) Upon a transfer under sub-section (1) ... of this section, the insurer shall ... be under the same liability to a third party as he would have been under to the insured ..."

Claims had arisen in respect of loss of cargo on insured vessels whose owners were members of P&I Clubs. The Club rules indemnified the members in respect of losses or claims which they "shall have become liable to pay and shall in fact have paid". The cargo owners obtained judgment against the members for damages and on failure to satisfy such judgment the members were wound-up. The cargo owners then began proceedings against the Clubs relying on s.1 of the Act, and claiming indemnity for their losses under s.1.

The House of Lords considered the interpretation of the "pay to be paid" provisions of the Club's rules and held that, on their ordinary construction, payment by the members to the third parties (i.e. the cargo owners) was a condition precedent to payment by the Clubs to the members. The 1930 Act could not transfer to the cargo owners any better rights against the Clubs than those which the member had previously possessed. As the members had not paid the cargo owners at the time of their winding-up, they had not complied with the condition precedent and the members had no right to indemnity. As a result, neither had the cargo owners and their claims against the Clubs failed.

The decision in this case resolves a dispute which has been going on for many years. Whilst the decision is very important in marine insurance, it is possible that non-marine insurers may not be able to take advantage of it. Normally, "pay to be paid" insurance would be unacceptable to the insured, who would have to pay the third party claim before he could recover under the policy. Such provisions would probably not be permitted in motor and employee insurances (i.e. cases where insurance is mandatory) and in other cases, the Insurance Ombudsman could be expected to take steps to prevent insurers of consumers relying on the *"Padre Island"* decision.

I will finish with a brief look at a case which is, unfortunately, only too relevant at the present time in that it concerned the definition of the word "insurrection". In *National Oil Company of Zimbabwe (Private) Ltd. v Sturge* (1991) 2 Ll. Rep. 281, supporters of Renamo, a Mozambican National Resistance Organisation, had, on several occasions, blown up an oil pipeline belonging to the National Oil Company of Zimbabwe. The oil company made a claim under a marine cargo insurance policy, which covered loss or damage caused by "any terrorist or any person acting for a political motive". A further clause provided that "in no case shall this insurance cover ... loss ... caused by war, civil war, revolution, rebellion, insurrection or civil strife". The underwriter contended that the claim was excluded because the losses were caused by civil war, rebellion or insurrection.

In giving judgment for the underwriters, the judge held that an "insurrection" for insurance purposes was an organised and violent internal uprising within a country, the main purpose of which was to overthrow or to supplant that country's government. "Rebellion" bore a similar meaning, but with a greater degree of organisation and size. Accordingly, a policy which excludes loss arising from "insurrection" excludes sabotage by an internal resistance force seeking to overthrow the govenment. It was Renamo's declared aim to overthrow the Frelimo Government and the fact that they were supported by South Africa, for reasons of its own, did not alter the nature of the uprising in such a way as to take it outside the definition of "insurrection".